Fiscal Democracy Approach: Evidence from Turkish Economy*

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Abstract

This study examines the concept of fiscal democracy, which is an important concept in terms of political and fiscal sustainability of public finance. As a result of this review, the Fiscal Democracy Index for the Turkish economy was calculated for the period from 1980-2018. The Turkish economy, divided into two periods, performed poorly in fiscal democracy between 1980-2001, while the second period, 2002-2018, showed an optimistic performance in Fiscal Democracy. Then, the relationship between fiscal democracy index and government expenditures and government revenues were tested empirically with a dynamic panel data analysis model. According to the findings, improvements in fiscal democracy have positive effects on government expenditure and government revenues.

Key Words: Fiscal Democracy, Turkish Economy, Government Expenditure, Government Revenue

I. Introduction

Budgets are an important tool for controlling public finances. Also, the state budget should be seen as a technical point of view as well as a political process of decision-making and allocation of resources concerning taxation and other resources (Singer, 1996: 21). Therefore, it is very important to discover the relationship between budgeting and society and the relationship between budgeting and democracy (Rubin, 1990: 187). At this point, it would be useful to talk about the concept of fiscal democracy. Because the concept of democracy is essentially a fiscal issue. Fiscal democracy exists when voters have the power to change government and determine fiscal policies (Genschel and Schwarz, 2013; Steurle, 2016).

Steurle (2010) and Steurle (2016) emphasized the political liabilities and constraints of yesterday's policymakers' preferences that affect the fiscal choices of today's government or parliament. To measure these constraints and liabilities, they developed the index of fiscal

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democracy index. The fiscal democracy index represents the percentage of public revenues in the budget remaining after subtract compulsory public expenditures (including public debt interest). Thanks to the index, changes in the public finance balance of countries can be observed and evaluations can be made about democracy or voting.

The chronic budget deficits and the rise in public debt in most democratic states leave future governments a bad political legacy. When the financing of the increasing fiscal deficits is met with borrowing, the interest burden on the budget increases and insufficient tax revenues destroy the democratic system. Given the fact that the fiscal problems that are often faced by democratic governments are in the shape of a budget deficit, fiscal sustainability and fiscal consolidations, these deficit or fiscal imbalances mean a decrease in fiscal democracy, that is, a symptom of a larger trouble. (Steurle, 2012). This trouble is closely related to the bad political legacy of former elected governments and parliaments. The bad political legacy decreases the capacity of present elected governments and parliaments to respond to social and economic troubles. This is because, it is quite difficult to eliminate the expenditure programs that have been decided and implemented in the previous period and it is a mechanism that increases costs just like compound interest (Streeck and Mertens, 2010).

In this study, the period covering the years 1980-2018 for the Turkish economy aims to analyze fiscal democracy. First of all, the fiscal democracy index of the relevant years will be calculated. Then, the obtained index will be tested with the help of two econometric models on the effect of government expenditures and government revenues.

II. Calculation of fiscal democracy index for Turkish Economy (1980-2018)

In the Fiscal Democracy Index, all current and transfer expenditures are considered as mandatory (rigid) expenditures while investment expenditures are assumed to be voluntary (flexible) expenditures. In addition to interest payments are considered as mandatory (in transfer expenditures) expenditures while capital transfers are accepted as voluntary expenditures.

Selecting the year 1980 is meaningful to analyze the Turkish economy. Because after this year, Turkey passed to a free market economy. Therefore, this choice, which will ensure that the analysis as a whole is consistent and effective also will be useful for evaluating the relationship between a free market economy and public finance.

Figure 1: Fiscal Democracy Index (1980-2018)

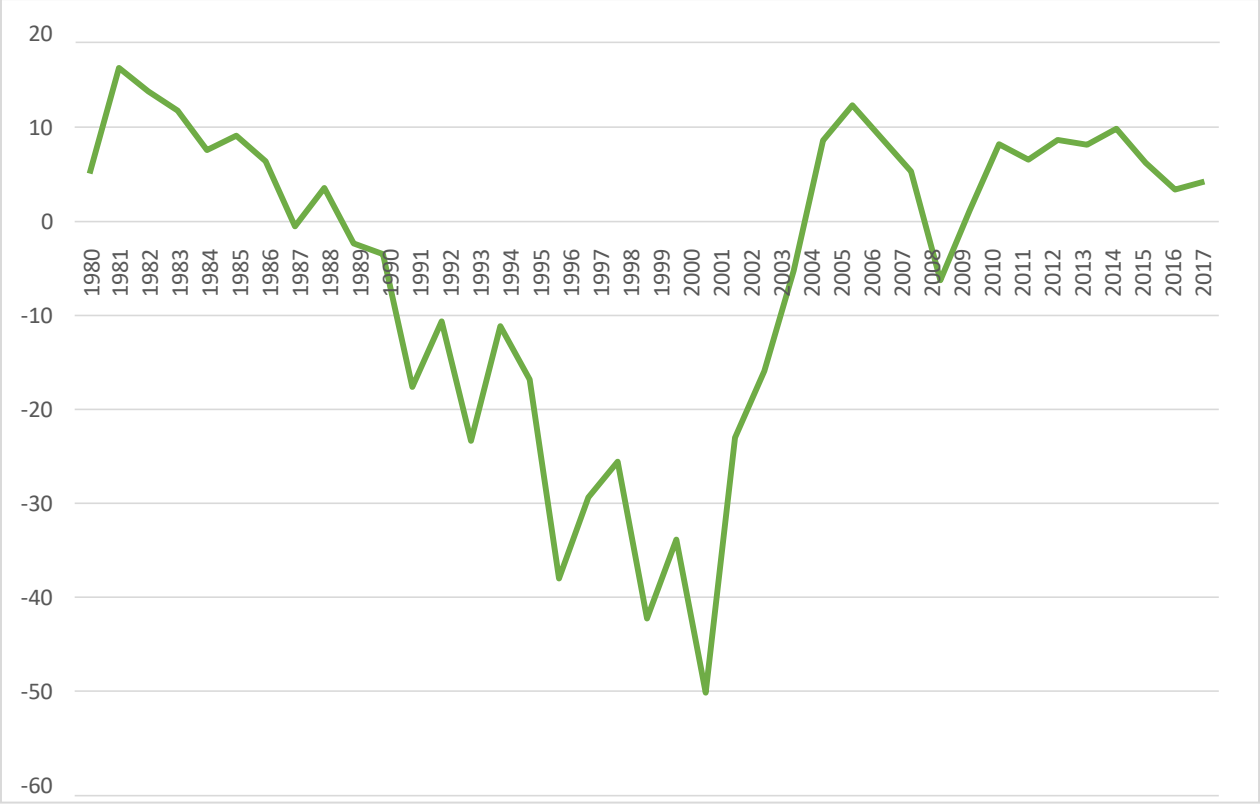

Figure 1 shows the fiscal democracy index for the Turkish economy. Before examining the fiscal democracy index in Turkey, it would be useful and meaningful to divide the two periods in the form of 1980-2001 and 2002-2018. Because the first of the two periods is political instability and the second is political stability. With the transition to a free-market economy, the fiscal democracy index reached its lowest point in 2001. In the first period, four reasons can be presented about such a large deterioration of the index: First, the acceleration in the process of globalization has forced countries to increase tax cuts, incentives, regulations, and government expenditure to attract foreign capital to their countries. The second is that Turkey faced political, financial and fiscal crises in 1994, 1998 and 2001. The third is high inflation rates. The fourth is the populist policies of governments. These causes have led to erosion of government revenues, an increase in government expenditures, a loss environment of confidence and economic recession. Therefore, deterioration in the public financial balance and fiscal democracy index was inevitable.

In the second period, in 2002-2018, a more optimistic performance is observed. Because, in the period, a management approach based on transparency, accountability, and efficiency in public finance was implemented associated with political stability. Therefore, it is clear that serious improvements have been achieved in the fiscal democracy index. Also, attention to Maastricht criteria of the budget balance and public debt stock indicators has been an effective factor to join the European Union. Although there was a decline in the index in 2009, it should be taken into account that the global crisis affected all countries of the world this year and that the momentum of recovery was again soon. In the post-2015 period, although the country faces severe political instability has led to a decline in the public finance balance and the fiscal democracy index, Turkey's economy still has a flexible fiscal space.

III. Econometric methodology and models

This study aims to empirically test the effect of fiscal democracy index on government expenditures and government revenues. In this context, the two models will be using. In this context, the two models will be used. In the first model, the relationship between public expenditures and fiscal democracy index will be tested, while in the second model, the relationship between public revenues and fiscal democracy will be tested. Descriptive statistics are presented in table 1.

Table 1: Descriptive statistics

Variable	Definition	Observation	Mean	Standard Deviation	Minimum	Maximum
FDI	Fiscal Democracy Index	39	-4.886163	17.24335	-50.1842	16.31652
GROWTH	GDP per capita growth (annual %)	39	2.83112	4.237051	-7.357	9.423771
EXP	Government expenditure (% GDP)	39	27.7407	9.762133	12.08656	48.01801
REV	Government revenue (% GDP)	39	22.44033	9.615577	9.655834	34.5573
INF	Inflation, consumer prices (annual %)	39	40.37397	30.6032	6.250977	105.215
DEBT	Government Debt (%GDP)	38	40.35105	12.62314	22.37	77.94
POP	Population	39	6.24e+07	1.11e+07	4.40e+07	8.23e+07

+ + + + + + + + + + + **(1)**

+ + + + + + + + + + + **(2)**

According to equation (1) and equation (2), independent variables of the model, FDI represent fiscal democracy index for Turkey (coverage period 1980-2018), GROWTH represents GDP per capita growth (% annual), INF represent inflation (consumer prices, annual %), DEBT represent government debt (%GDP) and finally POP is denoting population. In equation (1) dependent variable EXP denotes government expenditure (% GDP) while in equation (2) dependent variable REV denotes government revenue (% GDP).

GMM dynamic panel data analysis developed by Arellano-Bover (1995) and Blundell-Bond (1998) will be used to test the relevant equations. This analysis is important because it better reflects the dynamic nature of the real world. However, it should be noted that the more

advanced and detailed version of this analysis, the so-called xtabond2 command, is more effective. This command, developed by Roodman (2009), has chosen to provide diagnostic test results of the designed models.

IV. Estimation results

Table 2 presents the results of the analysis for dynamic panel data analysis.

Table 2: Analysis Results

Variable	Model 1 (EXP)	Model 2 (REV)
EXP L1	.5014566***	----------
REV L1	----------	.6382211***
FDI	-.0746263*	.1333437***
FDI L1	-.0978957*	-.1827805***
GROWTH	-.0974563	-.0616477
GROWTH L1	-.0974563	.1048618**
DEBT	.2438502***	.054925
DEBT L1	-.2375205***	-.0856937**
INF	-.1422725***	-.1137222***
INF L1	.0619376**	.0586778***
POP	-3.99e-06	-5.23e-06***
POP L1	4.31e-06	5.50e-06***
AR (1)	0.018	0.006
AR (2)	0.228	0.503
Sargan	0.199	0.204

Note: ***, ** and * denote significance 1, 5 and 10% levels.

According to Table 2, the GROWTH and POP variables for model 1 were statistically insignificant while all other variables were statistically significant. For Model 2, only non-lagged values of GROWTH and DEBT variables were statistically insignificant while others were statistically significant. Also, both models do not have autocorrelation and endogenous problems. When is examined Table 2 the relationship between FDI-EXP and FDI-REV, which is the focus of the analysis, it is possible to say: For Model 1, we can say that there is a negative but not very strong relationship between FDI and EXP. In other words, the fiscal democracy index increases while government expenditures decrease or vice versa. According to the results of Model 2, there is a positive but not strong relationship between FDI and REV. In other saying FDI index increases while government revenue increases or vice versa. Surprisingly, the relationship between the lagged value of FDI and the REV is negative and stronger. Therefore, the results suggest that the increase in fiscal democracy, in the long run, will decrease government revenues.

V. Conclusions

The concept of fiscal democracy is important in terms of both political and fiscal sustainability in public finance. Because this fiscal democracy should not be neglected in order that the governments of the future should not be in a difficult situation and that they can respond to the demands of the people as a requirement of democracy. Therefore, fiscal democracy should be a criterion in evaluating public finance. The Fiscal Democracy Index was calculated for the Turkish economy in the period coverage 1980-2018. The First period of 1980-2001 showed a weak performance in fiscal democracy while the second period of 2002-2018 has an optimistic picture in fiscal democracy. The reasons for the weak or bad fiscal democracy in the first period can be argued as follows: The first is the increase in government

expenditures (regulations, investments et al.) and the decrease in government revenues (tax breaks, incentives et al.) to attract global capital to the country. Secondly, the financial and fiscal crises of 1994, 1998 and 2001. Thirdly, the deterioration in public finances (both revenue erosion and serious increases expenditures) caused by these crises, loss of confidence and economic collapse. Fourth serious and high inflation rates. Finally, the populist policies and discourses of governments. Considering all these as a whole, the weakening of public fiscal balance and fiscal democracy was inevitable. In the second period, in 2002-2018, a more optimistic performance is observed. Because, in the period, a management approach based on transparency, accountability, and efficiency in public finance was implemented associated with political stability. Therefore, it is clear that serious improvements have been achieved in the fiscal democracy index.

When the results of the econometric model are considered, there is a large degree of agreement with our estimates. In the estimation made by two separate models and dynamic panel data analysis, the first model examines the relationship between fiscal democracy and government expenditures while the second model examines the relationship between fiscal democracy and government revenues. Also, both models do not have autocorrelation and endogenous problems. According to results, for Model 1, we can say that there is a negative but not very strong relationship between fiscal democracy and government expenditure. In other words, the Journal of democracy index increases while government expenditures decrease or vice versa. For Model 2, the results differ in part and surprisingly. Consistent with our expectations, there is a positive relationship between fiscal democracy and government revenues. Surprisingly and differently, in the long run, there is a negative relationship between fiscal democracy and government revenues. This result provides motivation for further research.

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